



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

U=

V=

Dear :

We have considered your ruling request dated February 28, 2013, and amended on April 4, 2014, concerning the tax consequences under section 511 of the Internal Revenue Code of 1986, as amended (hereafter "I.R.C."), related to merchandise sold at your museum gift shop.

Facts:

You are exempt from federal income tax under I.R.C. § 501(c)(3) and described in § 170(b)(1)(A)(vi). Your purposes include operating a museum and research center that provides a location to receive and display materials pertaining to U, including but not limited to V, and to educate the public about U and V, and outer space.

You maintain a museum gift shop on your premises. Museum gift shop business is also conducted through internet-order catalog sales. You sell items in your museum gift shop as part of your regular operations. The museum gift shop sells the following: items you describe as "toys" that pertain to the solar system; books and documentary videos on the topic of U and V; and, various items that contain a reproduction of the newspaper article reporting on V. You represented that these items pertain to U and V and outer space, and which are all substantially related to your exempt purpose. You provided copies of the descriptive literature/ educational material that accompany each item and a statement as to how the sale of each item contributes importantly to the achievement of your museum and research center's exempt educational purposes. You also provided photographs and physical descriptions of the items on which you are seeking a ruling, along with the descriptive literature/ educational material that accompanies each item. You have represented that the descriptive literature/educational material accompanying each item is based upon eye-witness accounts, referenced in various scholarly

material (available in both written and video format in your museum library) and/or also depicted in your museum's exhibits and displays. You represent that all these items help educate the public about U and V, and outer space.

Ruling Requested:

The sale of merchandise in your museum gift shop, referenced herein, contributes importantly to your exempt purpose and does not constitute unrelated business income under I.R.C. § 511.

Law:

I.R.C. § 501(c)(3) provides that a corporation organized and operated exclusively for charitable or educational purposes is exempt from federal income tax.

I.R.C. § 511 imposes a normal tax and surtax on the unrelated business taxable income of organizations exempt from taxation under § 501(c)(3).

I.R.C. § 512 defines "unrelated business taxable income" as income from any unrelated business "regularly carried on" by an exempt organization.

I.R.C. § 513(a) defines "unrelated trade or business" to mean any trade or business the conduct of which is not substantially related (aside from the need for income) to the exercise or performance of the organization's exempt purpose or function that constitutes the basis for its exemption under I.R.C. § 501.

I.R.C. § 513(c) provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate or similar activities, or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Treas. Reg. § 1.501(c)(3)-1(d)(3) defines "educational" to mean the instruction of the public on subjects useful to the individual and beneficial to the community.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii) provides that, "museum, zoos, planetariums, and other similar organizations" are examples of educational organizations.

Treas. Reg. § 1.513-1(b) provides that the primary objective of the adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the non-exempt business endeavors with which they compete. On the other hand, where an activity does not possess the characteristics of a trade or business within the meaning of I.R.C. § 162, such as when an organization sends out low cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations. However, in general, any activity of a I.R.C. § 501

organization that is carried on for the production of income and that otherwise possesses the characteristics required to constitute "trade or business" within the meaning of I.R.C. § 162 and that, in addition, is not substantially related to the performance of exempt functions presents sufficient likelihood of unfair competition to be within the policy of the tax. Accordingly, for purposes of I.R.C. § 513, the term "trade or business" has the same meaning it has in I.R.C. § 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services. Thus, the term "trade or business" in I.R.C. § 513 is not limited to integrated aggregates of assets, activities, and good will which comprise business for the purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose identity as trade or business merely because the pharmacy also furnishes supplies to the hospital and patients of the hospital in accordance with its exempt purposes or in compliance with the terms of I.R.C. § 513(a)(2). Similarly, activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical that contains editorial matter related to the exempt purposes of the organization. However, where an activity carried on for the production of income constitutes unrelated trade or business, no part of that trade or business shall be excluded from this classification merely because it does not result in profit.

Treas. Reg. § 1.513-1(c)(2)(ii) provides that, in general, exempt organization business activities that are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competition and promotional efforts typical of commercial endeavors. However, where the non-qualifying sales are not merely casual but are systematically and consistently carried on by the organization, they meet the requirement of regularity under I.R.C. § 512.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of I.R.C. § 513 only if the causal relationship is a substantial one. For this relationship to exist, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Rev. Rul. 73-104, 1973-1 C.B. 263, holds that the sale of greeting card reproductions of art works by an art museum exempt from tax under I.R.C. § 501(c)(3) does not constitute unrelated trade or business. Each card is imprinted with the name of the artist, the title or subject matter of the work, the date or period of its creation, if known, and the museum's name. The art museum sold these cards through a shop in the museum and through a catalogue that solicited mail orders. The rationale of Rev. Rul. 73-104 is that the card sales contribute importantly to the

achievement of the museum's exempt educational purposes by stimulating and enhancing public awareness, interest, and appreciation of art. Rev. Rul. 73-104 also states that the cards are promoted and sold in a clearly commercial manner at a profit, and competition with commercial greeting card publishers does not alter the fact of the activity's relatedness to the museum's exempt purpose.

Rev. Rul. 73-105, 1973-1 C.B. 264, holds that the sale of scientific books and city souvenirs by a museum of folk art exempt from tax under I.R.C. § 501(c)(3) constitutes unrelated trade or business even though other items sold in the museum shop are related to its exempt function. The revenue ruling describes an exempt museum of American folk art that offers for sale in its shop four categories of items, i.e., (1) reproduction of artworks from the museum's collection and from other art collections that take the form of prints suitable for framing, postcards, greeting cards, and slides; (2) metal, wood, and ceramic copies of American folk art objects from its collection and other collections; (3) instructional literature concerning the history and development of art, particularly folk art; and (4) scientific books and various souvenir items relating to the city in which the museum is located. All of its reproductions are imprinted with the name of the artist, the title or subject matter of the reproduced work, and the museum's name. It was concluded that categories (1), (2), and (3) contribute importantly to the achievement of the folk art museum's exempt educational purposes by making works of art familiar to a broader segment of the public, thereby enhancing the public's understanding and appreciation of art. The sale of scientific books and souvenirs described in category (4) was deemed to constitute unrelated trade or business, because the objects had no causal relationship to art or to artistic endeavor and thus did not contribute importantly to the accomplishment of the folk art museum's exempt purposes.

Rationale:

The terms "unrelated business income" pertains to income generated from the sale of goods or services as part of a regularly carried on trade or business that is not substantially related to the exempt purpose of the organization. See §§ 511, 512, 513(a), and 513(c). Because you sell items in your museum gift shop on a regular and routine basis, you are engaging in a regularly carried on trade or business. See §§ 1.513-1(b), 1.513-1(c)(ii). The only issue remaining is whether the sale of these items is substantially related to your exempt purposes. See § 1.513-1(d)(2).

A nexus between the items sold in a museum gift shop and the accomplishment of the museum's exempt purposes must be established before sales of the items can be considered substantially related within the meaning of § 513(a) and thus exempt from unrelated business income taxation. As such, the focus is on the primary purpose for the production and sale of each item. For example, if the primary purpose of the article is utilitarian, ornamental, or as a souvenir, it would not be considered substantially related within the meaning of § 513(a). The nexus that is established should also establish that an item relates specifically to the particular museum in which it is sold. Items that are of general educational value are not necessarily substantially related. For example, in Rev. Rul. 73-105, supra, sales of scientific books by a museum of folk art constituted an unrelated trade or business because of the lack of a causal relationship of the scientific books to the folk art museum's exempt purpose, even though those

scientific books were educational in and of themselves. Here, the various books and documentary videos on the topic of U and V, relate directly to your exempt educational purpose of educating the public about U and V, and outer space. As such, the sale of these items would not generate unrelated business income.

Generally, museum gift shop sales will not generate unrelated business income when the merchandise sold depicts items from the museum's collection and contains descriptive literature to educate the purchaser as to the significance of the item and its nexus to the educational purpose of the museum. See Rev. Ruls. 73-104 and 73-105, *supra*. Your museum gift shop sells items that contain a reproduction of the newspaper article reporting on V, such as posters, on coffee mugs, book markers, etc., along with various scholarly books and documentary videos pertaining to U and V, and outer space. These items are intrinsically educational and create a nexus with your exempt purpose. These items also contain accompanying descriptive literature, which educates the public about U and V and create a nexus with your exempt purpose of educating the public about U and V, and outer space. As such, the sale of these items would not generate unrelated business income.

The museum gift shop sells items that can generally be described as educational and interpretive teaching items for children that you broadly labeled as "toys." These items are jigsaw puzzles, posters, cartoon books and t-shirts pertaining to the solar system and contain educational material imprinted within and made part of the "toys." These items educate the public about the solar system and create a substantial nexus to U and V and your exempt purpose of educating the public about U and V, and outer space. As such, the sale of these items would not generate unrelated business income.

Conclusion:

We have determined that the sale of the various "toys" pertaining to the solar system; various books and documentary videos pertaining to U and V; and, items that contain a reproduction of the newspaper article reporting on V, contribute importantly to your exempt purpose and do not constitute unrelated business income under I.R.C. § 511.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, EO Technical

Enclosure
Notice 437